28 October 2013

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

AOSSG comments on IASB Exposure Draft ED/2013/7 *Insurance Contracts*

The Asian-Oceanian Standard-Setters Group (AOSSG) appreciates the opportunity to provide comments on the IASB Exposure Draft ED/2013/7 *Insurance Contracts*.

The AOSSG currently has 26 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan, and Vietnam.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. Each member standard setters may also choose to make a separate submission that is consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asian-Oceanian region and not to prevent the IASB from receiving the variety of views that individual member standard-setters may hold. This submission has been circulated to all AOSSG members for their feedbacks after having initially developed through AOSSG Insurance Contract Working Group.

AOSSG members are very supportive of the IASB's efforts to improve transparency in accounting for the effects of insurance contracts on an entity's financial position and financial performance and to reduce diversity in the accounting for insurance contracts.

Overall, AOSSG members are supportive of the general direction of the proposed model in ED/2013/7 while some AOSSG members express their concerns.

In addition, the AOSSG acknowledges that many preparers of financial statements are concerned about uncertainty associated with effective date of the proposed standard. In order to mitigate the uncertainty caused by the delay in finalizing the proposal, it is deemed necessary to provide a clear roadmap and concrete timetable for implementing the proposal.

The views of AOSSG are explained in more detail in the Appendix. If you have any queries regarding any matters in this submission, please contact us.

Yours sincerely,

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Appendix - AOSSG detailed comments on IASB ED/2013/7 ***Insurance Contract***

Question 1: Adjusting the contractual service margin
Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:
(a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and
(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?
Why or why not? If not, what would you recommend and why?

1. AOSSG members support the proposal in ED/2013/7 to unlock the contractual service margin (CSM), as it enables the CSM to represent the unearned profit that the entity recognises as it provides services under the insurance contracts. Members also agree that the CSM cannot be negative, consistent with the accounting treatment for impairment of assets set out in IAS 36 and IAS 39. However, some AOSSG members expressed views including:

   (a) while the basis stated in ED/2013/7 makes sense, the explanation given in the ED/2010/8 that the residual margin should represent the amount that eliminates any gains at inception is more convincing.

   (b) unlocking the CSM would increase the operational complexity in computing the CSM.

2. Most AOSSG members support the proposal that the difference between the current and previous estimates of fulfilment cash flows relating to future coverage be adjusted to the CSM on the basis that it relates to risks to be borne in the future. Also, these members agree with the proposal that the impact on the CSM resulting from a difference between assumed and actual experience be recognised immediately in profit or loss.

3. Some AOSSG members recommend that an improvement be made to the proposals to require a change in the risk margin relating to future coverage to be adjusted to the CSM. The change in the risk margin that relates to past coverage would continue to be required to be recognised in profit or loss immediately.

   Some members also noted that, for those entities that consider it is not feasible to allocate changes in the risk margin between that which relates to past and future coverage, the IASB should provide an 'impracticability' concession similar to that proposed as part of the transition requirements.

4. Notwithstanding the general support, some members are of the view that the proposal

concerning the CSM is very complex and there would be significant operational challenges in practice, at least in many jurisdictions, especially with regard to tracing data for a long period of time. These members believe that further consideration would be helpful to alleviate such practical challenges, including whether, and if so how, the re-measurement approach could be applied in determining an appropriate amount of CSM at each reporting date.

5. In addition, some AOSSG members are of the view that application guidance should be developed to paragraph 32 of ED/2013/7, such that the CSM should be recognised in profit or loss over the coverage period in a more consistent manner. Considering the magnitude of determining an appropriate pattern, they are of the view that providing robust guidance to assist insurers to identify appropriate 'profit drivers' would be helpful to increase the comparability of financial statements of insurers.

Question 2: Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

(a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?

(b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (i.e. using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?

(c) recognises changes in the fulfilment cash flows as follows:

(i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;

(ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and

(iii) changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements

of the [draft] Standard?
Why or why not? If not, what would you recommend and why?

6. Most AOSSG members support in principle the 'mirroring' approach, which would eliminate or significantly reduce accounting mismatch between underlying items and the corresponding insurance liabilities.

7. A number of AOSSG members are, however, concerned about the following issues.

   (a) Requirements for applying the mirroring approach are not clearly defined in ED/2013/7, which could cause confusion in practice. In particular, some preparers are concerned about the ambiguity as to the extent and manner in which the mirroring approach would be applied to insurance products whose underlying assets are managed based on a company-wide portfolio rather than a separated portfolio.

   (b) Specific application guidance is not provided in ED/2013/7 so as to identify whether fulfilment cash flows 'are directly linked to', 'are indirectly linked to' or 'do not vary with' the underlying assets. This could pose challenges to preparers and auditors in exercising significant judgment, and lessen the comparability of financial statements between entities.

   (c) Except for the case where fulfilment cash flows are directly linked to returns on underlying items, it is deemed impracticable to decompose cash flows that are indirectly linked to the underlying assets.

   (d) The mandatory nature of the exception could result in insurance contract liabilities being measured on a different basis from other similar insurance liabilities on the grounds of the specific arrangements in place.

8. Based on the concerns in the previous paragraph, some AOSSG members recommend the following.

   (a) The IASB needs to clarify whether participating contracts and insurance contracts whose underlying assets are linked to company-wide portfolio fall under the application exception for the mirroring approach. If not, selective application of the mirroring approach should be allowed considering the costs and burdens borne by preparers.

   (b) To improve understanding of the mirroring approach, detailed guidelines should be provided as to how insurers identify whether fulfilment cash flows are linked to returns on underlying assets and how to decompose fulfillment cash flows should be provided.

Question 3: Presentation of insurance contract revenue and expenses
Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an

entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?
Why or why not? If not, what would you recommend and why?

9. Most AOSSG members support the gross presentation of insurance contract revenue and expenses as proposed in ED/2013/7, because it generally brings the requirements of insurers in line with those of non-insurers, and it would enhance the comparability of financial statements between industries.

10. However, the AOSSG members are divided in their views about the proposal to separate all investment components from the host insurance contracts. While most members are supportive of the proposal (paragraph 9 above), other members suggest alternative ways to present insurance contract revenue and expense (paragraphs 11 and 12 below).

11. As noted, in paragraph BC76 of ED/2013/7, the proposals should be broadly consistent with the general principles in the IASB's 2011 Exposure Draft *Revenue from Contracts with Customers*, such that an entity would depict the transfer of proposed coverage and other services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the coverage and other services, as it satisfies its performance obligations.

12. Some AOSSG members suggest that, in the case of insurance contracts containing both insurance risk and other risks, only the investment components that are not closely related to the insurance component can be separately presented. This reflects the concern of some preparers that the proposal in ED/2013/7 would essentially require that even pure death benefits and annuity benefits are accounted for as investment components.

13. Also, other AOSSG members suggest an alternative approach that the estimated sum of premium to be received from insurance contracts be allocated to the remaining contractual term in accordance with the manner that best reflects the remaining transfer of services that are provided under the contract.

Question 4: Interest expense in profit or loss
Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:
(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and

(b) recognising, in other comprehensive income, the difference between:

- **(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and**
- **(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?**

Why or why not? If not, what would you recommend and why?

14. Many AOSSG members support the proposal that an entity should recognise in other comprehensive income the difference between the carrying amounts of the insurance contract measured using the discount rates that are applied at the reporting date and those at the date that the contract was initially recognised. This is primarily because the proposal can mitigate the variability of profit or loss while presenting the performance of insurers' underwriting and investing activities from the effects of changes in the discount rate that are expected to unwind over. However, these AOSSG members also expressed the following concerns:

    (a) the effect of changes in discount rates to be recognised in OCI should be limited to the insurance contracts that do not have interest-sensitive cash flows; and

    (b) the proposal may result in significant operational complexity in identifying changes in insurance contract liabilities that are directly attributable to the subsequent change in discount rates.

15. Other AOSSG members do not support the presentation for changes in insurance contract liabilities attributable to discount rate due to a conceptual point of view (paragraph 16 below) and an operational perspective (paragraph 17 below).

16. The proposal would create another measurement model for insurance contract liabilities, and would add more complexity to the already complex array of measurement models in IFRS. In addition, the isolation of discount rate changes in OCI may create artificial profit or loss volatility as the impact of naturally offsetting variables such as inflationary effects are recognised in profit and loss and OCI.

17. The proposals would involve identifying and tracking of changes in discount rates of a contract from initial recognition. However, it is not clear what unit of account should be employed for identifying and tracking discount rates by all contracts each month, quarter, year, or each time in which discount changes. Depending on how the unit of account is defined, tracking discount rates could pose significant challenges for insurers and many would need to develop new information systems to meet the requirements.

18. Furthermore, some AOSSG members noted concerns expressed from their stakeholders that the proposed accounting requirements would give rise to accounting mismatches,

where risks arising from assets and liabilities of an entity are matched economically, because re-measurement gains or losses from some financial assets, including derivatives, would be measured at FVPL, while the effects on changes in discount rates on insurance contract liabilities would be presented in profits or losses in the statement of comprehensive income.

Question 5: Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

19. Most AOSSG members agree with the proposed approach to transition on the grounds that this is deemed a better alternative than the 2010 ED proposals that would have prohibited recognition of CSM for contracts in force at transition. In addition, these members note that, even though this approach is likely to result in significant costs being borne by preparers, the benefit from implementing the proposals is likely to exceed the costs.

20. Some AOSSG members expressed the following concerns in implementing the proposals:

    (a) the retrospective estimates of CSM would be impracticable, because it is very difficult and burdensome to trace past information.

    (b) the effective date of the proposals should be aligned with that of IFRS 9 *Financial Instruments*.

    (c) the proposal does not provide the definition of 'objective information' used in calculating the CSM for contracts in force at transition. Therefore, due to the ambiguity of the concept of 'objective information', the result of initial application of the proposal might vary depending on the interpretation of 'objective information' by preparers.

21. One AOSSG member proposes an alternative approach which permits using the measurement results under current IFRS 4 *Insurance Contracts* when it is expected that preparers would bear excessive costs due to the lack of available information. According to this alternative, the measurement of CSM arising from insurance contract liabilities that are in force at the date of transition would be divided to the following components depending on the time of writing.

    (a) For the contracts written before a specific point of time (e.g., the date of announcement of new insurance contracts standards), CSM could be measured as the difference between the fulfilment cash flows and the carrying amount of insurance liabilities under current IFRS 4 only if they satisfy the liability adequacy test.

(b) For the contracts written after a specific point of time, CSM could be measured using retrospective estimates as proposed in ED/2013/7.

Question 6: The likely effects of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?

Please describe the likely effect of the proposed Standard as a whole on:

(a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and

(b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

22. Although AOSSG members are supportive of the IASB's objective of formulating a common comprehensive IFRS, the IASB needs to be mindful of the different starting points of each relevant jurisdiction. On balance, most AOSSG members consider the costs of complying with all of the proposals in ED/2013/7 would not justify the benefits that the information will provide.

23. Some AOSSG members believe that insurers would change their management system to focus on the management of financial volatility or risks upon adoption of the standard. Some AOSSG members believe that its suggested changes to the proposals, particularly with respect to making the recognition of the impacts of changes from historical discount rates in OCI a conditional option, and the changes to the 'mirroring' proposals, would ease the transition to a high quality common IFRS standard for insurance contracts.

Question 7: Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

If not, please describe any proposal that is not clear. How would you clarify it?

24. The following have been highlighted as examples where more clarity of the IASB's intent would be helpful:

(a) the variable application of discount rates at subsequent periods for different products on offer as well as a linkage to the cash flows;

(b) the treatment of endowment policies irrespective of the terms as deposits rather than premiums;

(c) revenue from investment-linked contracts;

(d) determination of the liability for future coverage under the simplified approach;

(e) the implication that the risk adjustment can be calculated for gross claims and reinsurance recoveries separately;

(f) the relationship between the requirements on combining contracts and separating contracts; and

(g) unit of account terms, for example, 'portfolio' and 'contract' appear to be used in an inconsistent manner.

25. One AOSSG member has concerns with the combination of insurance contracts being advocated when any one of the three conditions in paragraph 8 of ED/2013/7 is met, due to the impracticality of valuing differing expected cash flows from the various contracts issued to the same policyholder on the same risk.

26. A further concern has been raised that ED/2013/7 provides a number of examples for the BBA approach but does not provide sufficient examples to assist in interpreting how the simplified approach is expected to be applied.

27. Two members expressed the view that there is a need to clarify accounting treatments when a favourable change arises subsequent to a series of unfavourable changes. If residual CSM is smaller than the adjustment amount deducting CSM when unfavourable change in estimates of future cash flows relating to future coverage and services arises, the part of the adjusting amount which exceeds the residual CSM should be recognised as a loss. However, it is not clear whether entities would be required to adjust (increase) the CSM or to recognise a profit in subsequent periods when a change in estimates of future cash flows is favourable. Therefore, it is necessary to provide clear guidance on this situation.

28. Another AOSSG member has the following drafting concerns:

(a) Provide illustrative examples providing detailed accounting treatment

It is necessary to provide detailed accounting for each case to assist in users' understanding of the proposals.

In Example 6, the insurance contract liability at inception is zero, but it seems that the carrying amount of the insurance contract liability should be CU900 because the insurer receives the premiums of CU900. Therefore, this member considers users could misunderstand the example without another example with detailed accounting.

(b) Clarify the presentation of unit-linked contracts

ED/2010/8 proposed to present liabilities from unit-linked contracts and underlying assets linked to the liabilities and income and expense from the liabilities or assets as separate single items in financial statements.

On the other hand, in ED/2013/7, the presentation proposals relating to unit-linked contracts are deleted with no basis. Therefore, it is necessary to clarify the presentation of unit-linked contracts and the rational for deleting the proposal in ED/2010/8.

(c) Clarify the criteria for classifying direct and indirect acquisition costs.

(d) Provide detailed application guidance on how to release CSM and the unit of account for releasing CSM.

Some preparers propose the following drafting clarifications in relation to disclosures. The main concern raised by preparers is the vulnerability of providing sensitive information about key strategic information and the lack of equity compared to the banking industry.

(i) To consider exemption from the disclosures of comparative information in the reporting period before the transition date.

(ii) To consider withdrawing the proposal to disclose a reconciliation from the premiums received to the insurance contract revenue because premiums received is generally level premiums that are not relevant to the revenue.

(iii) To consider withdrawing the proposal to disclose inputs used when determining the insurance contract revenue, because all information about profits and costs would be exposed.

(iv) To consider withdrawing the proposal to disclose the information about new contracts because it could provide inaccurate information to users.

29. Some interested parties would like clarification of the methodology to measure risk adjustments and application guidance on how to estimate long-term interest rates.

30. Meanwhile, insurance entities in some jurisdictions commented that recycling should be required for FVOCI equity instruments category to be consistent with recycling for FVOCI debt instruments. This is because of the specificity of asset management by some insurance entities in emerging jurisdictions and because long-term bonds matched with long-term insurance liabilities are not frequently traded in emerging jurisdictions, and insurance entities generally construct an investment portfolio with equity instruments and debt instruments to match returns and durations with particular insurance contracts.